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# Year-end Tax Planning Considerations

## December 2015

Welcome to DDW Electronic Tax Update. We hope you will find this information interesting and helpful.

As the year-end approaches it is a good time to evaluate your tax planning and address any time-sensitive decisions. We have prepared this newsletter to keep you up-to-date on income tax changes and areas that may be of interest to you.

**Topics Covered:**

1. Owner Remuneration - Payment of Salary or Dividend
2. Income Splitting Opportunities
3. Contribution to Retirement Tax Plans (RRSP, TFSA)
4. Triggering Tax Losses
5. Tax Deductions and Credits for 2015
6. Corporate Tax Considerations

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## 1. Owner Remuneration - Payment of Salary or Dividend

As the corporate year-end approaches shareholders must consider the amount of shareholder draws from the company and the expected shareholder loan account balance at year-end. This is important because an overdraft in the shareholder loan account will need to be corrected and could result in personal taxes if the loans are not repaid within one year of the year-end (as long as the repayment is not part of a series of loans and repayments).

As a business owner, you will have a choice whether to structure the repayment of the shareholder loan account as salary or as dividends.

### Considerations for salary

- Employment income from salary or bonuses generates RRSP contribution room. If it is important to you to be able to make RRSP contributions, you should consider structuring some of your compensation as a salary or bonus. The contribution room generated will be 18% of earned income to a maximum of $24,930 in 2015. This means that salaries and bonuses up to $138,500 will allow you to generate maximum RRSP contribution room.
- Employment income will also be subject to payroll withholding. Non-arm's length employees, such as shareholders and their family members, will not have to pay EI premiums on employment earnings. However, both the employer and employee portion of CPP will still need to be paid on employment income. CPP contributions will increase your eventual CPP pension benefits, but you may wish to avoid paying into CPP by choosing to take dividends as compensation instead, as CPP contributions are not paid on dividends.
- Salaries and bonuses are deducted as expenses of the corporation thereby reducing the corporate taxable income. Bonuses can be used to reduce corporate income to the small business deduction limit (2015: $500,000).
- Bonuses deducted as an expense by the corporation will need to be paid out within 179 days of year end. For a December 31st, 2015 year-end, bonuses will need to be paid by June 26th, 2016. The bonus is deductible by the corporation in its 2015 year-end but the bonus is picked up as employment income in the 2015 calendar year resulting in a potential tax deferral.

Considerations for dividends

- Dividends are not deductible as an expense; they are paid out of retained earnings. Dividends are subject to favorable personal tax treatment since the income has already been taxed at the corporate level. Dividend income will generate a dividend tax credit on your personal tax return. Dividend income, eligible dividends in particular, may trigger alternative minimum tax if most of your income comes from dividends.
- Depending on what type of income the company earns, there may be a choice between paying eligible and ineligible dividends. Eligible dividends are taxed at lower personal tax rate than ineligible dividends. Eligible dividends are available if the corporation has a balance in its general rate income pool (GRIP). A GRIP balance arises when a corporation has taxable income that is taxed at the general rate and does not benefit from the small business deduction.
- If the company earns investment income (as opposed to active business income) or receives dividends from an investment portfolio it may have Refundable Dividend Tax on Hand (RDTOH). Eligible dividends should be paid in order to recover a dividend refund in the corporation of 33.3% of the dividends paid to shareholders. If eligible dividends are unavailable, there is potentially a higher combined taxes by the shareholder and the corporation if ineligible dividends are paid.
- Another factor to consider is whether your corporation can pay capital dividends. Capital dividends are tax free to the shareholders receiving them. The capital dividend account will generally consist of the one-half, non-taxable portion of any capital gains that the corporation has realized from selling capital property. Capital dividends paid from other corporations would also be included in the capital dividend account.

In order to provide tax planning and determine the most advantageous mix of salaries and dividends (both eligible and ineligible), an estimate of a shareholder's personal income levels, the corporation's income and the balances in the shareholder's loan accounts will be required.

## 2. Income Splitting Opportunities

Tax efficiency that may be achieved by having additional income taxed by family members in a lower tax bracket. One way to achieve this is for salaries to be paid to family members. Any salary that is paid should be at the fair market value of the work performed. Dividends may also be used to split income, however, the impact of attribution rules must first be considered.

## 3. Contributing to Retirement Tax Plans

Registered Retirement Savings Plans (RRSP)

The deadline for making a 2015 RRSP contribution is February 29, 2016. Before making RRSP contributions, ensure that you have RRSP contribution room as 1% tax per month will be applied to RRSP contributions that exceed your deduction limit by more than $2,000. Your notice of assessment for the previous tax year will show your RRSP contribution room.

If you draw money from a corporation in the form of a salary and contribute it to an RRSP once you hold the money personally, the taxes paid overall will end up being very similar to leaving the money in the corporation or distributing it to a holding company, which can act as a "personal RRSP."

Tax Free Savings Account (TFSA)

For 2015 you can contribute up to $10,000 annually to a TFSA as long as you are 18 years or older and a resident of Canada. The contribution limit is likely to decrease to $5,500 in 2016. TFSAs do not provide a tax deduction, however, the investment income earned inside of a TFSA is tax free and any unused amounts are carried forward.

Funds can be given to a spouse or common-law partner for them to invest in their TFSA and normal attribution rules would not apply.

## 4. Triggering Tax Losses

If you own investments with unrealized losses, you may consider selling them prior to December 31, 2015 in order to offset against current year capital gains or to carry back to the previous three taxation years. There are rules in place for creating an artificial loss that need to be considered. Specifically that you do not buy similar property 30 days subsequent to the sale of the property.

## 5. Tax Deductions and Credits for 2015

In order to be eligible for certain deductions and credits, the following payments should be made prior to December 31, 2015.

- Charitable gifts
- Medical expenses
- Union and professional dues
- Certain Investment Council Fees
- Political contributions
- Children's fitness and arts tax credit

## 6. Corporate Tax Considerations

Corporations that are Canadian-controlled private corporations (CCPCs) are eligible for the small business deduction for income up to $500,000. Income beyond $500,000 is subject to higher corporate tax rates.

For 2015, combined BC and Federal income that is eligible for the small business deduction is taxed at 13.5%. For income above the $500,000 threshold, the general rate is 26%. Investment income earned in a CCPC is taxed at 45.67%.

As part of your year-end tax planning, you may want to consider reducing your corporate income to the small business deduction by paying out bonuses in order to benefit from the lower tax rate for the corporation. As well, there may be opportunities to utilize losses in other related companies.

If funds are to be reinvested in the corporation, a taxpayer may wish to pay corporate income tax at the general rate and defer payment of dividends and the personal income taxes that would be incurred on a bonus.

### Capital Cost Allowance (CCA)

Another factor to consider as your year-end approaches is the purchase of capital assets. For tax purposes, the business can claim a tax depreciation deduction called Capital Cost Allowance (CCA) on property and equipment.

In the year of acquisition you can only deduct one-half of the normal rate of CCA. If you purchase and place assets into use close to your year-end, you will effectively be accelerating the rate at which you can claim CCA since you will be able to claim CCA for one-half of the year. Therefore, it may be advantageous to purchase assets at the end of the fiscal year rather than the beginning of the new fiscal year.